

**FOLLOW-UP REVIEW OF
PARENT AND DEPENDENT DUPLICATE
EXEMPTION CLAIMS**

Reference No. 091000

Date: December 7, 1998

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

2d = Law Enforcement Technique(s)

**Follow-up Review of
Parent and Dependent Duplicate Exemption Claims**

Table of Contents

Executive Summary	Page i
Objective and Scope	Page 1
Background	Page 1
Results.....	Page 2
Management is implementing our recommendations as part of an on-going national strategy on Invalid and Multiple Use of SSNs	Page 2
Management is segmenting the duplicate SSN population for research and testing	Page 3
Management is testing and measuring the effectiveness of notices and correspondence examinations in improving compliance	Page 4
Conclusion	Page 6
Detailed Objective and Scope of Review	Attachment I

Follow-up Review of Parent and Dependent Duplicate Exemption Claims

Executive Summary

In 1996, Internal Audit issued a report on Parent and Dependent Duplicate Exemption Claims (Reference No. 063502). That report advised Service management that action was needed to reverse the continuous and costly problem of duplicate social security numbers (SSNs) use and recommended that management:

- Identify solutions that minimize both taxpayer burden and impact on the Service's resources.
- Segment the condition for control and aggressive management.

Management agreed with our recommendations and placed the Duplicate Dependents Project in the fiscal year (FY) 1996 Research Plan. The North Florida District Office Research and Analysis (DORA) function is in charge of the project. Internal Audit has been supporting the project by identifying the duplicate SSN population each year and providing the needed master file extracts.

The overall objective of this follow-up review was to determine whether agreed to corrective actions were implemented and how their implementation benefited the IRS. The review was conducted in the North Florida District (NFD) DORA function and in the National Office in accordance with generally accepted government auditing standards. The results included in this follow-up report were primarily based on information contained in the Duplicate SSN Research Report issued by the NFD DORA in May 1998. We relied heavily on the data provided by DORA to maximize use of audit resources.

Results

Management is implementing our recommendations as part of an on-going national strategy on Invalid and Multiple Use of SSNs. This strategy should help reverse the increasing use of duplicate SSNs that we identified in our prior report. Management's efforts since we first reported this issue have shown some initial positive results in identifying potential solutions for the duplicate SSN problem. However, these initial results are not complete and management plans to continue their testing.

Management's initial actions to address our recommendations include the following:

- Segmenting the duplicate SSN population for research and testing. Management's profiling efforts on the tax year (TY) 1994 duplicate SSN population showed that approximately half of the population was the result of invalid SSN use. Since new laws allow the Service to disallow the use of invalid SSNs by math error correction procedures, DORA focused their attention on the valid SSNs in the duplicate population.

Follow-up Review of Parent and Dependent Duplicate Exemption Claims

Segmenting the TY 1995 valid duplicate SSN population showed that duplicate claims were largely composed of three groups.

- Duplicate dependents (36% of the population)
 - Duplicate Earned Income Credit (16% - most included duplicate dependent claims)
 - Dependents who filed as primary taxpayer (48% of the population)
- Testing and measuring the effectiveness of notices and correspondence examinations in improving compliance. Management sent notices to a small sample of TY 1995 taxpayers in the above three categories. The notices advised the taxpayer that two or more tax returns, including theirs, used the same SSN to claim a tax benefit. The notices asked the taxpayer to determine if they were entitled to the claim, and if not, to refrain from using the SSN in the future. One notice also requested an amended return for TY 1995. The notices showed positive results in improving future compliance among the taxpayers.

Based on these results, management sent notices to a major portion (2.1 million) of the TY 1996 duplicate SSN population in December 1997. They plan to measure the results of the mailout (including compliance improvement), perform a cost/benefit analysis, and issue recommendations for 1999.

Management also conducted correspondence examinations on a nationwide sample of approximately 3,000 repeat taxpayers (those in the TY 1995 duplicate SSN population that were also in the TY 1994 duplicate SSN population). These examinations resulted in approximately \$3.2 million in adjustments to taxpayers' accounts. Approximately \$1.6 million of the \$3.2 million had been collected at the time of our review. Collection actions are still in process and may result in additional recovery of revenue. The correspondence examinations were also helpful in improving future compliance.

The above results have provided management with valuable insight on the duplicate SSN population which can be used to identify cost effective solutions that protect revenue and minimize both taxpayer burden and impact on the Service's resources. Management plans to continue their research and make recommendations to improve compliance after all analyses are completed.

Based on management's on-going national strategy efforts, we are not making further recommendations at this time. Management agreed with the facts presented in this follow-up report.

Follow-up Review of Parent and Dependent Duplicate Exemption Claims

Objective and Scope

The overall objective of this review was to determine whether agreed to corrective actions from our Internal Audit report on Parent and Dependent Duplicate Exemption Claims issued April 30, 1996, were implemented and how their implementation benefited the IRS. We conducted the review in accordance with generally accepted government auditing standards. Audit work was performed between December 1997 and August 1998, in the North Florida District Office Research and Analysis (DORA) function and in the National Office. We relied heavily on the data provided by DORA to maximize use of audit resources.

To accomplish our objective we obtained profile and research reports on duplicate exemption claims, and verified data for examinations conducted at the Memphis Service Center on a sample of taxpayers with duplicate exemption claims.

To accomplish our objective, we:

1. Met with DORA personnel, obtained profile and research reports, and reviewed information related to the Service's efforts to address the use of valid¹ duplicate social security numbers (SSNs).
2. Obtained and verified data for examinations conducted at the Memphis Service Center (MSC) on a sample of taxpayers with duplicate exemption claims for tax year (TY) 1995.

The detailed objectives and scope of this review are presented in Attachment I. We did not follow-up on efforts to address the use of invalid SSNs on duplicate exemption claims since another Internal Audit review was focusing on those efforts.

Background

On April 30, 1996, we issued an Internal Audit report on Parent and Dependent Duplicate Exemption Claims (Reference No. 063502) after an Internal Audit analysis showed a nationwide three-year trend of increasing use

¹ A valid SSN for DORA profile efforts is an SSN that passes the validity tests performed during return processing indicating the SSN belongs to the dependent or qualifying child. Invalid SSNs do not pass validity tests 2d-----

Follow-up Review of Parent and Dependent Duplicate Exemption Claims

of duplicate SSNs. The report also showed that mailing letters to taxpayers was effective in causing a change in filing behavior in a small sample of taxpayers over a two-year period. The report noted that action was needed to ensure the Service can effectively reverse the continuous and costly problem of duplicate use of SSNs, and recommended that management:

- Identify solutions that minimize both taxpayer burden and impact on the Service's resources.
- Segment the condition for control and aggressive management.

These recommendations were not intended to be the sole actions needed to correct the problem of the increasing use of duplicate SSNs, but to enable the Service to start analyzing the problem so that cost effective solutions could be identified and pursued. Management agreed with our recommendations and placed the Duplicate Dependents Project, to be conducted by the DORA functions in the North and South Florida District offices, in the Fiscal Year (FY) 1996 Research Plan. Internal Audit has been supporting the project by identifying the duplicate SSN population each year and providing the needed master file extracts.

Results

Management is implementing our recommendations and is following a course of action that should help reverse the increasing use of duplicate SSNs identified in our previous Internal Audit Report.

Management is implementing our recommendations as part of an on-going national strategy on Invalid and Multiple Use of SSNs. This strategy was initiated in FY 1997, and should help reverse the increasing use of duplicate SSNs identified in the previous Internal Audit Report. Management is taking the following actions:

- Segmenting the duplicate SSN population for research and testing.
- Testing and measuring the effectiveness of notices/letters and correspondence examinations in improving compliance.

These initial actions have provided management with details about the duplicate SSN population which can be used to identify cost effective solutions that minimize

Follow-up Review of Parent and Dependent Duplicate Exemption Claims

both taxpayer burden and impact on the Service's resources. Correspondence examinations conducted at the MSC as part of management's corrective actions resulted in approximately \$3.2 million in adjustments to taxpayers' accounts related to duplicate exemption claims on TY 1995 returns. Approximately \$1.6 million of the \$3.2 million has been collected as of July 1998.

Management is segmenting the duplicate SSN population for research and testing.

The North Florida and South Florida DORA Offices profiled the TY 94 and TY 95 valid duplicate SSN population, and made recommendations for additional research, testing and treatment efforts (notices/letters or examinations).

The North Florida and South Florida DORAs issued a profile report on the TY 1994 duplicate SSN population in September 1996. The most significant finding from their profile effort was that approximately half of the population was the result of invalid SSN use. Due to new laws that allowed the Service to disallow the use of invalid SSNs by math error correction procedures, DORA continued additional research and testing mainly on the valid duplicate SSN population.

The North Florida District (NFD) DORA segmented the TY 1995 valid duplicate SSN population of approximately 3.2 million² returns for research, testing and treatment efforts (letters/notices or examinations) into three groups:

- Duplicate dependents (36% of population).
- Duplicate Earned Income Credit (EIC) (16% - most also include duplicate dependents claims).
- Dependent also filing as primary taxpayer (48.0%).

Further segmentation divided these groups into repeaters and non-repeaters. The Duplicate SSN Research Report issued by NFD DORA in May 1998 indicates that repeat taxpayers, those in the TY 1995 duplicate population that were also in the TY 1994 population, represented about 34% of all returns in the population. Conversely, the other 66% of the returns represented new duplicate SSN usage. Segmenting the duplicate SSN population

² We are presenting results as reported by DORA. We did not verify their data or the methodology used to arrive at the data since it was outside of the scope of our review.

Follow-up Review of Parent and Dependent Duplicate Exemption Claims

should help management better define actions needed to address duplicate SSN use by specific categories of taxpayers. The NFD DORA report recommends continued research and testing on the TY 1996 duplicate SSN population.

Management is testing and measuring the effectiveness of notices and correspondence examinations in improving compliance.

Management is testing and measuring the effectiveness and efficiency of the following efforts to address the increased use of duplicate SSNs and improve compliance:

- Sending soft notices/letters.
- Conducting correspondence examinations.

Management is testing and measuring the effectiveness of customized notices and correspondence examinations in improving compliance, and pursuing taxpayer education and prevention efforts.

Management is also pursuing taxpayer education and prevention efforts such as the Earned Income Tax Credit (EITC) Communications Study. The ongoing study will provide the National Office Communication Division and the Tax Forms and Publications Division with information that will enable them to improve the effectiveness of EITC outreach, educational activities and tax forms and instructions.

Soft notices - The NFD DORA mailed two types of notices to a small random sample of the TY 1995 duplicate SSN population just before the TY 1996 filing season. The notices advised the taxpayer that two or more tax returns, including theirs, used the same SSN to claim a tax benefit. The notices asked the taxpayer to determine if they were entitled to the claim, and if not, to refrain from using the SSN in the future. One notice also requested an amended return for TY1995.

The Duplicate SSN Research Report issued by the NFD DORA in May 1998, states that overall, notices are far more likely to cause improved compliance for the next year than the filing of amended returns. The report shows that:

- The notices were effective in improving compliance by about 16% (87% of all taxpayers who received a notice [test groups] did not repeat a duplicate SSN

Follow-up Review of Parent and Dependent Duplicate Exemption Claims

claim in TY 1996 compared to 71% for taxpayers who did not receive a notice [control groups]).

- Only 3% of all taxpayers in the sample filed amended returns for TY 1995 (as of May 1997).

Based on preliminary results of their findings, the NFD DORA recommended a nationwide mailout of notices to a major portion (2.1 million) of the TY 1996 duplicate SSN population in an effort to improve compliance on TY 1997. The NFD DORA customized the four types of notices mailed in December 1997, to better match the characteristics of the duplicate conditions and reduce burden to the taxpayer. The NFD DORA plans to measure the results of the mailout (including compliance improvement), perform a cost/benefit analysis, and issue recommendations for FY 1999.

The Service benefited from the correspondence examinations conducted at the MSC by approximately \$3.2 million of revenue protected, of which approximately \$1.6 million has been collected.

Correspondence Examinations - In order to learn more about the duplicate SSN population, the NFD DORA also selected a nationwide sample of repeater returns from the TY 1995 duplicate SSN population for correspondence examinations. The examinations were conducted at the MSC. All dependent and qualifying children claimed on the returns were questioned using a standard initial contact letter that was mailed by early December 1996, in an effort to also improve compliance on TY 1996 returns.

The May 1998 NFD DORA report shows that examination contact letters were effective in causing repeater taxpayers to improve compliance (76% of all taxpayers in the sample did not repeat a duplicate SSN claim in TY 1996 compared to 50% in the repeater control groups, a 26% improvement).

We analyzed master file data for the 3,215 SSNs provided by DORA to the MSC for the correspondence examinations (see Attachment I, Test III, for further details). Our analysis shows that approximately \$3.2 million in revenue was protected³. We verified these results by reviewing a statistically valid sample of 150 examination packages using stop and go sampling. No errors were found. Approximately \$1.6 million of the

³ Total revenue protected includes all adjustments made to taxpayers' accounts, i.e., additional tax, interest, and penalties assessed and credits disallowed.

Follow-up Review of Parent and Dependent Duplicate Exemption Claims

\$3.2 million has been collected as of July 1998, on accounts that were paid in full when selected for examination by DORA.⁴ Collection actions are still in process and may result in additional recovery of revenue.

Conclusion

The Service is following a course of action that should help reverse the increasing use of duplicate SSNs identified in the previous Internal Audit report. Appropriate actions are being taken to identify solutions that address duplicate dependent exemption claims. If management continues this course of action, they should be able to identify and implement cost effective solutions to address this problem. Correspondence examinations conducted as part of management's corrective actions resulted in approximately \$3.2 million of protected revenue of which approximately \$1.6 million has been collected as of July 1998.

Deborah H. Glover

Deborah H. Glover
Audit Manager

⁴ Amounts collected include payments and credits transferred from other tax periods. It does not include amounts paid on accounts that were not paid in full, e.g., accounts in installment agreement status.

Detailed Objectives and Scope

The objectives of this follow-up audit were to determine whether agreed to corrective actions were implemented and how the implementation of these corrective actions benefited the IRS. To achieve these objectives, we conducted the following tests for each recommendation.

Recommendation #1: Identify solutions that minimize both taxpayer burden and impact to the Service. The cost of addressing duplicate use of social security numbers (SSNs) through the examination process not only would create a tremendous burden to innocent taxpayers but also could severely strain Service resources. To address the problem, the Service should identify cost-effective ways to influence taxpayer actions that may be more effective overall than examining tax returns.

Tests:

- I) To determine if management had identified solutions that minimize both taxpayer burden and the impact to the Service, we:
 - A) Obtained and reviewed documentation from the North Florida District Office Research and Analysis (DORA), National Office Compliance Research, Revenue Protection Strategy (RPS) meetings, and other documentation related to the Service's efforts to address the duplicate SSN problem.
 - B) Discussed with National Office and DORA staff efforts to address our recommendations and identify non-enforcement actions.

Recommendation #2: Segment the condition for control and aggressive management. Because of the magnitude of the overall condition, the problem of duplicate SSN usage should be addressed by segmenting the individual patterns of misuse.

Tests:

- II) To determine whether management segmented the individual patterns of misuse for control and aggressive management, we:
 - A) Met with DORA personnel in the North Florida District (NFD) to discuss their efforts to profile the duplicate SSN population.
 - (1) Obtained documentation of the results of DORA profiling efforts and evaluated DORA recommendations for addressing the conditions identified.
 - (2) Identified management efforts to address DORA's recommendations.

**Follow-up Review of
Parent and Dependent Duplicate Exemption Claims**

- (3) Determined the status of correspondence examinations conducted at the Memphis Service Center (MSC) at DORA's request in order to gather more information about the duplicate SSN population.
- III) To determine the financial benefits to the Service from the correspondence examination conducted at the MSC, we:
 - A) Calculated adjustments to taxpayers' accounts by analyzing 199512 master file data for the 3,215 social security numbers provided by DORA to the MSC under a specific project code and source code.
 - (1) Calculated additional assessments using an electronic extract of master file data posted between the opening and closing date of the examinations requested by DORA.
 - (2) Verified our calculation of the additional assessments attributable to DORA by matching our electronic master file data to 150 examination packages selected from a statistically valid sample of 400 SSNs using stop-and-go sampling.
 - B) Calculated the amount collected on these assessments by identifying payments and credit transfers from other tax periods posted after the opening date of the correspondence examination.
 - (1) Identified those accounts that were in full-paid status prior to the DORA examination.
 - (2) Calculated the total amount of payments and credit transfers that posted to these accounts.
 - (3) Ensured the validity of data extracted from the master file by selecting a judgmental sample of transactions and verifying the data in each record to the corresponding data on master file using the Integrated Data Retrieval System (IDRS).